Decision 02-12-059 December 17, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Gas Company Regarding Year Six (1999-2000) Under Its Experimental Gas Cost Incentive Mechanism and Related Gas Supply Matters.	Application 00-06-023 (Filed June 15, 2000)

ORDER MODIFYING AND DENYING REHEARING OF DECISION 02-06-023

Southern California Edison Co. (SCE) has filed for rehearing of Decision No. 02-06-023. This decision approved the extension of Southern California Gas Co.'s (SoCalGas or SoCal) Gas Cost Incentive Mechanism (GCIM) as modified by a Settlement Agreement executed by SoCalGas, the Office of Ratepayer Advocates (ORA) and The Utility Reform Network (TURN). The decision also directed the Commission staff to prepare an Order Instituting Investigation (OII) into the gas market activities of SoCal and the other market participants during the 2000-2001 time period.

The GCIM is a ratemaking mechanism designed to provide greater benefits to ratepayers than annual reasonableness reviews of SoCal's gas procurement activities. It includes an incentive for SoCalGas to make sound gas purchasing decisions by awarding company shareholders 50 percent of any savings it achieved by purchasing gas below market price benchmarks and disallowing 50 percent of gas costs above the benchmarks.

The Settlement Agreement adopted several modifications proposed for the GCIM in a report submitted by the Commission's Energy Division. In particular, sharing of savings were increased in favor of ratepayers, and a cap of 1.5 percent of total gas costs was established on the shareholder award. The Year 7 shareholder award, which under the unmodified GCIM would have totaled $106.1 million, was reduced to $30.8 million as a result of the parties' agreement to apply the revised cap to that year's results.

Two parties, SCE and the Southern California Generation Coalition (SCGC), opposed the Settlement Agreement. Although they generally agreed with incentive-based regulation of gas procurement activities, they sought additional changes to the GCIM to provide more safeguards to protect the interests of noncore customers. SCE argued that the GCIM created perverse incentives for SoCalGas to increase gas prices during the 2000/2001 winter season. This contention and other complaints by SCE and SCGC about the mechanism, including allegations that SoCal has an information advantage in gas procurement activities that allows it to dominate and manipulate the Southern California gas market, were rejected by the Decision on the ground that they lacked sufficient evidentiary support.

In its application for rehearing, SCE[1] states that the Decision "is incorrect as a matter of both fact and law"; that the modified GCIM continues to create harmful incentives that allow SoCalGas to raise gas procurement prices for its own profit through the sharing mechanism; and argues that Findings of Fact (FF) Nos. 9 and 10 should be deleted because they are inaccurate and irrelevant. It contends that its evidence demonstrates that under the GCIM SoCal is able to raise gas prices at the California border and that it has done so by utilizing hub transactions (e.g. gas lending and parking services); and by choosing not to withdraw gas from storage in December, 2000. It asserts that the Decision fails to properly discuss its evidence; and that FF Nos. 9 and 10 are erroneous.

[1] SCGC did not file an application for rehearing.

SoCalGas and ORA each filed a response to SCE's application. Both maintain that SCE's application repeats arguments that it made during the proceeding, which were rejected.

SoCalGas contends that the GCIM worked as planned in the crisis conditions of 2000-2001 in that it was able to use the various cost-saving operations, including physical purchases and sales of gas, hub loans to noncore customers in the summer of 2000, and transactions such as futures contracts and swaps, to produce the lowest gas costs for its core customers. It maintains that the high prices of 2000-2001 were caused by external forces, including the unprecedented high demand for gas-fired electric generation which increased by 100 Billion Cubic Feet (Bcf) in Year 7 over Year 6; a pipeline rupture and supply interruption on El Paso Natural Gas Co.'s (El Paso) pipeline system; unseasonably cold weather that dramatically increased gas heating load by 38 Bcf; and the low utilization rate (12 percent) of the storage capacity rights assigned to noncore customers, which could have provided a hedge against high winter gas prices. With regard to SCE's request to delete FF No. 9, SoCalGas contends that the request is illogical - - that just because SoCal achieved greater cost savings in Year 7 when external events forced border prices up there is no reason to conclude that the GCIM must have created an incentive for SoCal to do so.

SoCal also disagrees with SCE's position that the gas utility uncharacteristically had net injections of gas into storage rather than the customary net withdrawals for the month of December. Specifically, SoCalGas points to testimony by its witness that there was a small net withdrawal (2.5 Bcf) in that month. It refutes SCE's allegations regarding its storage activities by claiming that it met its core storage target by filling almost 85 percent of core storage capacity. Accordingly, it maintains that FF No. 10 is correct.

ORA's Response agrees with SoCal that SCE's application raises no new grounds of error and merely repeats the same arguments it presented during the proceeding. The Response further agrees with SoCal that the Decision is fully supported by substantial evidence. In addition, it charges that SCE has misrepresented the evidence related to its allegation that SoCal contributed to the price spikes of December 2000 by making an unprecedented amount of gas loans and then agreeing to have over 10 Bcf of the loaned gas set for repayment in the winter season. It points to the unusual situation that the 2000 winter gas prices were forecast to be lower than the current summer prices as the cause of the large amount of gas loans in the summer rather than any nefarious change in gas purchase strategy by SoCal. It also points to the fact that the total volume of hub gas loan and parking transactions was less in Year 7 than in Year 6. Finally, it states that there is no evidence showing at the time of the summer loans that SoCal knew that the upcoming winter would be unusually cold, or that there would be a severe drought in the Northwest. ORA concludes that, since the loan repayments were scheduled far in advance of these unusual weather events, combined with the loss of interstate pipeline capacity from the El Paso line rupture, SCE's contention that the loan repayment schedule was the cause of price spikes and that SoCalGas manipulated its activities under the GCIM to achieve this result has no merit.

We have reviewed SCE's allegations, and we conclude that it has not demonstrated any legal error. The essence of SCE's claim is that the even under the Settlement Agreement the GCIM permits SoCal to use hub transactions in such a manner that the result is larger core savings, which in turn result in a larger share award for its shareholders. To demonstrate the presence of such action by SoCal it relies on SoCal's activities in the 2000-2001 time period. The difficulty in advancing this position is that there were an unusual set of conditions present in the time period under review. The primary legal issue raised by SCE is whether there is substantial evidentiary support for FF Nos. 9 and 10, which respectively find unpersuasive its evidence as to the creation of perverse incentives in the GCIM and which rejects its showing relating to the alleged improper core storage during Year 7.

After reviewing the record, we conclude that there is adequate evidentiary support for the Decision. There is no doubt that border gas prices rose dramatically in the 2000-2001 period. There is also no doubt that various external factors, such as the supply shortfall on the El Paso system, the abnormal weather conditions, and a large increase in demand from the generation market, described in the testimony of witnesses, were present. Their existence was not challenged by SCE. It relies on the increase in the volume of gas sales and the increase in the total cost of the gas at the border in Year 7, but ORA points out that the total of these volumes was less than the total in Year 6 of the GCIM. (Exh. 4) Furthermore, because summer 2000 prices were higher than expected winter gas prices, noncore customers declined to use their purchased storage capacity and instead chose to secure a large quantity of gas loans totaling 17.2 Bcf with repayment of about 10.9 Bcf scheduled for December 2000 and January 2001. (Exh. 4, p. 10; Record Transcript (RT) p. 156). Noncore customers, not SoCal, determined when the loans were to be repaid (RT p. 206). This repayment situation contributed to the existence of high prices, but there is no showing that SoCal planned this result.

On the other hand, SCE's evidence is not persuasive because it does not consider several of the unusual external factors described above. SCE's showing in this proceeding falls short of demonstrating that there has been intentional, premeditated actions to manipulate the market to achieve larger shareholder awards. According to SCE, the GCIM's inclusion of hub wholesale physical and financial transactions in the calculation of compliance with the benchmark results in perverse incentives. While it is possible SCE's allegations are correct, a thorough investigation involving all the major participants in border price transactions, including the members of SCGC, SCE and Pacific Gas and Electric Co., should be undertaken before further modifications to the GCIM are adopted. The OII directed by the Decision in Ordering Paragraph No. 6 should accomplish this goal. (OII No. 11-02-040 issued November 21, 2002.) However, because the Decision does not contain a finding of fact regarding the unusual external factors present during the period under review, we will modify FF No. 9 to reflect their existence.

Likewise, SCE's assertion that SoCal engaged in improper storage activities lacks record support. Contrary to SCE's claim that gas was injected into storage during December 2000, SoCal presented unrefuted testimony to the effect that it actually withdrew a small amount of gas at that time. (RT pp. 217-18) In addition, the record shows that SoCal utilized about 85 percent of its core storage capacity. (RT pp. 31-33) On the other hand, noncore customer storage achieved a level of only about 12 percent of capacity. (Id.) Moreover, noncore customers voluntarily entered into storage gas loan arrangements during the summer of 2000 and set repayment for the coming winter season on the expectation that the winter gas prices would be lower. (Id.) At the time it was not known that the winter weather would be unusually cold and that the availability of Northwest electricity would be lessened by drought conditions. Under the storage rules in effect at the time the core storage target was met by SoCal (Ex. No. 18, p. 3) Thus, FF No. 10 is literally correct. Furthermore, the Settlement Agreement ameliorates this situation by imposing a physical storage requirement of 70 Bcf in gas supply in storage by November 1 (Id. p. 4); and by providing that in the future hub gas loans will not be counted toward the storage target.

We conclude that good cause for rehearing has not been shown. However, we will modify FF No. 9 to reflect the existence of the various external factors that were present during the time period under review.

THEREFORE, IT IS ORDERED that:

1. Decision No. 02-06-023 is modified to revise Finding of Fact No. 9 as follows:

> "9. During the time period under review in this proceeding border gas market conditions included various external factors, such as unusually cold weather, very high electric generation demand, drought conditions in the Northwest, and a supply disruption on the El Paso pipeline system. Although gas prices increased during this time period, Edison has not offered any persuasive evidence in this proceeding that shows the GCIM standing alone creates perverse incentives for SoCal Gas to increase gas prices at the California-Arizona border."

2. SCE's application for rehearing of Decision No. 02-06-023 is denied.
3. This proceeding is closed.

Dated December 17, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners